Testimony of

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Hearing on The Debt Collection Improvement Act of 1996: How Well Is It Working?

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I am pleased to be here today to discuss with you the implementation of, and compliance with, the Debt Collection Improvement Act of 1996 (DCIA) by the Department of Education, with special emphasis on my area of responsibility, the Office of Federal Student Aid (FSA). I am the Chief Operating Officer for FSA. FSA is the organizational unit within the Department of Education with the operational responsibility for the collection of defaulted student loans and, to a great extent, the implementation of the DCIA. FSA provides specialized debt management services for the defaulted student loan portfolio held by the Department of Education.

The Department has undertaken a broad range of activities over the past two decades to continue improving our debt collection efforts, and we are committed to expanding and refining our efforts in the future. The enactment of DCIA made the most sweeping changes for Federal debt collection management since the Debt Collection Act of 1982. This legislation provided Federal collection officials with some new collection tools, and it also imposed upon these officials some new requirements.

Five years ago, FSA was created as the Federal Government's first performance-based organization (PBO). Under the PBO, we refined our debt collection efforts. We improved our contracts with collection agencies and are in the process of fully implementing the administrative wage garnishment provisions of the DCIA. We also enhanced collaborative efforts with postsecondary schools, guaranty agencies, and lenders to reduce the likelihood of default by borrowers in both the guaranteed and direct student loan programs.

Secretary Paige found that there were serious management problems when he arrived at the Department of Education in January 2001. The Department had not received a clean audit opinion in years, and there was not an expectation of one in the near future. He made it one of his top priorities to identify and correct all of the management problems that were preventing the Department from operating at peak performance. When I came on board in October 2002, I immediately focused on the FSA Annual Plan for Fiscal Year (FY) 2003 and worked with FSA senior leadership to develop a plan that addressed the important legislative mandates of the PBO, as well as these key management problems. We recognized that our Default Management and Prevention Strategies, which included increasing default collections, were an important component of our plan, and the tools provided under DCIA were key to our meeting our collection goals in this area. I am pleased to say that as a result of FSA's and the Department's focused efforts, in January 2003 the Department received a clean opinion on its financial statements for the first time since 1997. In addition, we have ensured that the management processes and procedures are in place, or planned, to sustain this important objective.

Our Challenge

For many years now, the Department of Education has been the primary source of federally supported student loans. The William D. Ford Federal Direct Loan (Direct Loans) and Family Federal Education Loan (FFEL) programs, the two primary loan programs administered by the Department, have enabled millions of students to afford to go to college. Through these programs, students have received over $500 billion in loans since the enactment of the Higher Education Act of 1965 (HEA). The vast majority of student loan borrowers have repaid or are currently repaying their loans, and the outstanding loan portfolio, including direct and guaranteed loans, was approximately $280 billion at the end of FY 2002. However, some borrowers default on their loans. The Department is determined to prevent defaults, and if they occur, to see defaulters fulfill their obligations to repay their loans.

Our challenge in FSA is to collect defaulted student loans. This challenge is considerable because student loans are inherently risky due to the characteristics of the borrower population and the design of the programs themselves. Student loans are available to borrowers who might otherwise not be able to obtain credit in the private sector to ensure their access to higher education. Thus credit-worthiness is not normally a prerequisite for eligibility for a student loan, although credit checks are required in the case of parent borrowers, and those who are in default on previous student loans are not eligible for additional loans. Because the loans are unsecured, the government and private lenders are left with no collateral to collect against in the event of default. Student loan borrowers frequently relocate after leaving school, which often makes it difficult to contact them for the purpose of servicing and collecting loans. All of these factors combine to make student loan collections uniquely challenging.

Our Response

Institutional and Administrative Debt

The Department also collects on liabilities other than those owed by individuals who have defaulted on education loan or grant overpayment obligations. To collect these other debts, referred to as institutional and administrative debts, the Department uses processes outside of the systems established for student aid debts. The Department was one of the first to participate in the Department of the Treasury's Cross-Servicing Program and has been transferring delinquent institutional and administrative debts to Treasury since October of 1996. Currently, the Department has forwarded approximately 95 percent of all institutional and administrative debts eligible for cross servicing to Treasury.

Administrative Wage Garnishment

The Department is moving forward with its efforts to implement the administrative wage garnishment authority provided in the DCIA to collect institutional and administrative debt owed by individuals. Final regulations regarding the Department's administrative wage garnishment process became effective on March 21, 2003. We are now in the final stages of implementing administrative wage garnishment for institutional and administrative debt through the Department of the Treasury's Cross-Servicing Program.

Debt Owed by Individuals (Defaulted Student Loans)

The Department has undertaken many initiatives to improve collections on defaulted loans. Those actions, including the implementation of the DCIA, have resulted in the continuous improvement of the Department's effectiveness in collecting defaulted student loans. In recognition of our past and continuing success, on May 11, 2001, the Department of the Treasury granted the Department a permanent waiver to allow it to service its own defaulted student loans.

From the late 1970's through the 1990's, the Department implemented a number of the debt collection tools that were subsequently required of all agencies by the DCIA. The use of private collection agencies, Treasury offset and administrative wage garnishment, Federal salary offset, credit bureau reporting and the requirement of taxpayer identification numbers have been in place at the Department of Education for many years. I will highlight some of our accomplishments that conform to the major provisions of the DCIA. Since passage of the DCIA, FSA has recovered over ***$8 billion*** in defaulted student loans.

Private Collection Agencies

Since 1979, FSA has continued to expand its relationships with collection agencies to maximize the recovery of defaulted student loans. The decision to contract for services by private collection agencies has been one of our most successful management decisions. We presently have 20 private collection agencies under contract. Our most recent contracts have several performance-based evaluation measures, making the contracts models for performance-based contracting in the Federal Government. The private collection agencies are evaluated and rated according to the overall service they perform, as well as their ability to collect defaulted student loan debt. The collection agencies that perform best across all of these categories receive additional incentives--both monetary rewards and new account placements.

Today, FSA is the largest debt collection outsourcer in the Federal Government -- we have approximately $14 billion in defaulted student loans currently under management with twenty contractors, including two small businesses through set-aside contract awards. Over the past seven years, private collection agencies have generated over ***$1.2 billion*** in collections. More than ninety percent of these collections represent borrowers making regular monthly payments on their defaulted student loans, or borrowers satisfying their obligations in full. FSA collection contracts rely on a contingent fee method of compensating collection agencies—meaning that the collection agencies are paid only for results achieved.

We have worked hard to establish a culture of performance and accountability with collection agencies over the years. The Department of Education has established the ground rules for healthy competition, as well as the guidelines and requirements for protecting the rights of defaulted student loan borrowers, and we have placed incentives in the areas where we want to focus the efforts of the collection agencies. Private collection agencies prepare the litigation referrals, which are critical to DOJ's ability to secure judgments and recoveries on defaulted loans. DOJ remittances to the Department of Education have totaled more than ***$200 million*** during the same period of time. FSA also realizes significant collections from accounts that are managed by the Department. FSA internal collections total ***$518 million*** since 1996. The Department of Education continues to be focused on enabling defaulted borrowers to repay their loans, and offers a variety of different loan repayment options. Loan rehabilitation, loan consolidation, and income sensitive/contingent repayment plans are options that are available to defaulted student loan borrowers and are less punitive than traditional collection activities. In addition, FSA private collection agencies have been instrumental in assisting student loan borrowers to refinance over ***$2.8 billion*** dollars in defaulted indebtedness over the past seven fiscal years.

The use of private agencies has also allowed Education to dramatically reduce costs. In FY 1993, the contractors were paid roughly 33 cents for every dollar collected. After new contracts were competed and awarded in FY 1997, the costs were reduced to 23 cents per dollar collected. In our existing contracts, our costs are now down to only 16 cents per dollar, and are expected to be reduced even further during our next competition and award process, which is scheduled for late in FY 2004. These cost reductions are the result of improved debt collection tools, better contract management, and the competitive nature of the contracts. The result is that while yearly collections from private agencies have increased by over 130% since FY 1997, related collection costs during the same period have been reduced by over 30% (and over 50% since FY 1993).

Treasury Offset

The Department began referring eligible debts, those we previously tried to collect using all other available tools, to the IRS in 1986. For Treasury's 2003 offset year, the Department referred over ***$17 billion*** in defaulted student loan debts, including debts owed on Federally-reinsured loans held by State and non-profit loan guarantors, and institutional receivables to Treasury for offset. For the first eight months of fiscal year 2003, the Department offsets are nearly ***$705 million***. Treasury offsets on student loan debts referred by the Department, including Federally-reinsured debts held by guaranty agencies, have totaled ***$5.4 billion*** since 1996.

Administrative Wage Garnishment

"Administrative" wage garnishment has become an effective tool in improving our collections on student loans. We began using this tool under HEA authority eight years ago, and there are approximately 72,000 defaulted loans now in garnishment. This year we are in the process of implementing the similar garnishment authority provided to Federal agencies under the DCIA, which allows the withholding of up to 15% of the debtor's disposable pay, rather than the 10% now allowed under the HEA.

In order to maximize the effectiveness of wage garnishment, we worked with Congress on legislation that gave the Department the authority to receive important information on borrower employment from the National Directory of New Hires. Access to this data allowed us to locate more borrowers and ultimately generate significantly greater collections through the use of voluntary payment options and enforced actions.

Federal Salary Offset

The Department matches defaulted student loan records with Federal employment records to identify and collect by Federal salary offset from Federal employees who are in default on their loans. We have found these matching activities to be quite effective and have collected ***$46 million*** since FY 1996 from Federal employees. In addition, the Department was the first Executive Branch agency to work with the IRS to match delinquent and defaulted student loan records with IRS addresses. The Department began matching activities over 19 years ago.

Credit Bureau Reporting

Another of our long-standing initiatives to improve collections is the reporting of delinquent student loans to credit bureaus. The Department began this activity 21 years ago. After all due process procedures have been observed, and a borrower has been given sixty days to respond to the Department's notification of its intention to report the delinquency, FSA reports the debt to the appropriate credit bureaus on a monthly basis. We believe credit reporting has been an important factor in both reducing the student loan default rate and increasing the amounts we have collected on defaulted student loans.

Taxpayer Identification Numbers

The Department has also required all student loan borrowers to provide taxpayer identification numbers for at least 20 years. Without this safeguard, our success in collecting on delinquent and defaulted student loans would have been significantly hampered.

Conclusion

I believe the steps we have taken in compliance with the DCIA have made a significant contribution to the recovery of institutional and administrative debt and debt owed by individuals. We continually evaluate state-of-the-art collection techniques to ensure we are optimizing collections. In addition to realizing a record year for combined recoveries on debts owed by individuals, we will see collections by private collection agencies higher this year than in any previous year. I am very pleased to announce that FY 2003 is proving to be another very successful collection year for the Department of Education.

However, at FSA, we are not resting on our debt collection accomplishments. We know that default prevention is at least equal in importance to debt collection. The Secretary's Default Initiative, supported by amendments to the HEA, has continued to help us reduce student loan cohort default rates to below six percent for each of the last two years – the lowest levels ever. Outreach efforts like our Student Loan Repayment Symposium, National Default Prevention Days, and debt management partnership with the National Council of Higher Education Loan Programs indicate that we place a high value on default prevention. Looking to the future, our debt management strategy must be one that emphasizes mitigating risk through portfolio management and appropriate use of tools for default prevention, along with the full implementation of DCIA to improve collections.

I want to thank you for the opportunity to discuss the significant progress the Department has made in improving debt collection. We look forward to continued congressional support as we work to make further improvements in this area. I will be pleased to answer any questions you may have about the debt management program.